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Management Report: The Massachusetts Division of Insurance From 1975 to 1978

PROGRAM DEVELOPMENT

Division of Insurance

Commonwealth of Massachusetts

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Management Report:
The Massachusetts Division of Insurance
From 1975 to 1978

PROGRAM DEVELOPMENT

Prepared by Andrew F. Giffin, First Deputy Commissioner

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Introduction

This is the second part of a two-part series of management reports on the Massachusetts Division of Insurance from 1975 to 1978. The first part, titled "Administration," described the organizational structure, management, staffing and budget of the Division. This second part describes the functional units of the Division and their principal activities.

Included also is a list of official documents which have been compiled in a series of appendices. These documents provide voluminous detail on the subjects indicated. The full appendices are available for inspection at the Division's offices. Individual documents may be obtained by writing to the Massachusetts Division of Insurance at 100 Cambridge Street in Boston.

I. Administration and Research Bureau

Administration Section

The administrative functions of personnel, payroll, budget, and supplies were the joint responsibility of the First Deputy Commissioner and the Commissioner's personal staff prior to January of 1975. In the reorganization completed in August of 1976, all of the various administrative functions were consolidated into an Administration Section reporting to a new Director of Administration. Authority over insurance company licensing and policy forms was transferred to other Bureaus in the Division. The Administration Section remains under the First Deputy Commissioner, who also supervises the Research and Education Section and the Hearing Officers Section.

James Corum assumed the duties of Director of Administration in August of 1976. He was immediately charged with establishing formal Division operating procedures and a management information system. He and his staff produced a series of Administrative Bulletins recording the managerial progress. The first two Administrative Bulletins, issued in August and September of 1976, greatly strengthened the Division's policy discouraging potential conflicts of interest with Insurance Division employment. A bulletin on attendance recordkeeping in October of 1976 discontinued the use of individual employee sign-in and sign-out sheets. Responsibility for work habits was instead vested with section supervisors. Another bulletin in the same month established rules for the

appearance of the Division's physical plant and set aside a limited sum of money per section for enhancing the appearance of the office. Administrative Bulletins followed concerning photocopying, skeleton forces on partial holidays, printing, pick-up and delivery, travel expenses, office solicitations, sick and vacation leave, and check distribution.

In March of 1977, the Administration Section distributed an outline of available employee grievance procedures including both civil service and union mechanisms. In April and June, a new system of supply distribution and stockroom operation was announced to expedite access to needed supplies while maintaining sound inventory control. In July of 1977, the Administration Section introduced an employee performance evaluation report form and mandated formal performance evaluation for each employee twice a year. No regular evaluations had previously been made of employee performance and few written records of performance had been kept. In November of 1977, the Administration Section promulgated a tuition reimbursement policy offering financial support for employees taking work-related courses; level of reimbursement was inversely tied to salary level. Employees were actively encouraged to enrich their skills through additional academic training.

Concurrent with the development of formal administrative systems, the Administration Section constructed a management information system including periodic reports of essential budget and personnel information. Budget control reports were prepared on a monthly basis showing current monthly expenses and cumulative fiscal year expenses compared with appropriated amounts by subsidiary account and special funds reservations. After the first year of reporting, analysis of subsequent year expenditure levels could be compared to the first year experience to identify seasonal patterns and to plan future spending.

Over 90% of the Division's budget is for the cost of permanent personnel. The Administration Section produced a monthly report of current personnel obligations, adjusted to reflect expected pay level increases and salary reserves. Separate accounting was developed for the Division's administration account and the Board of Appeal. Estimates were made of the cost of filling vacancies for comparison with existing surpluses in the personnel account. Approximately four months prior to the close of each fiscal year, the report added a projection comparing requested amounts for the following fiscal year with the annualized cost of current personnel levels. This report served as a valuable tool for planning personnel actions and adjusting program plans to match available funds.

In addition to the regular monthly reports, special reports were produced from time to time as needed, detailing individual subsidiary accounts. Accounts were carefully monitored to anticipate occasionally necessary transfers of funds from one account to another. As each fiscal year progressed, it was necessary to consider both the budget activity of the current fiscal year and the next fiscal year's proposed budget. By the time each current year's appropriation was

enacted, work had already begun on a budget for the following year. Agency requests are filed in August. Secretariat recommendations are submitted in October and the Governor's recommendations are released in December. Each year, from January to July, the Administration Section was responsible for monitoring the progress of the Division's budget to assure that both the House of Representatives and Senate fully understood the needs of the Division. As soon as House and Senate Ways and Means Committees' recommendations were made to the full bodies and each house acted on the budget, reports were prepared to compare them with the original request.

In addition to the activities described above, the Administration Section developed a complete equipment inventory, repair status reports, equipment replacement need reports, and other miscellaneous reports. With the reorganization in August of 1976, the Division's telephone system was completely overhauled, substantially reducing the number of instruments and intercom systems. Without these changes in telephone equipment, increases in unit service charges would have pushed total system costs well beyond budget limits.

Until 1976, the Division had no organized method of retiring files to archives. Records were stored in expanding numbers of file cabinets in the Division's main office with no written inventories or retrieval systems. By August of 1976, over a hundred file cabinets had been removed from the office, many hundreds of boxes of records had been moved to remote storage, and files were reorganized by section with only those most commonly used retained in the office. The Administration Section is now completing a total file inventory and record retention system.

James Corum left the Division in 1977 to accept a position as the chief executive of the state's Merit Rating Board. He was replaced as Director of Administration by Susan L. Fessenden.

Research and Education Section

One of the most important organizational changes undertaken in 1976 by the Division was the establishment of a research and education staff. This staff of seven was designed to include specialists in diverse areas of expertise. The new section was charged with the analysis of important regulatory problems insulated from the pressures of day-to-day operational responsibilities. The section was also to administer the Division's work in consumer education through the preparation of operational, technical and popular publications.

The research and education section was originally constituted with two lawyers, one with an undergraduate background in economics; an MBA with a concentration in health management; an experienced legislative researcher; a communications specialist; and a statistician. The Director, Vincent F. Travis, had a master's degree in Social Service and an extensive background in insurance regulation.

The most important substantive issue in insurance facing Massachusetts in recent years has been the price of automobile coverages, particularly in urban areas. Boston was reputed to have the highest rates in the country, and the rate adjustments under the 1976 competitive rate law resulted in large, sudden increases for many policyholders. The first major task of the research section was to determine exactly how the 1977 rate increases were distributed among different groups of policyholders. This work helped lay the foundation for the complete reappraisal of traditional auto insurance pricing assumptions which occurred in connection with the 1978 rate hearings. In response to many requests for information on the new pricing structure implemented in 1978, the section designed, collected, and edited a book entitled Automobile Insurance Risk Classification: Equity and Accuracy containing the Commissioner's decision and five research papers of the State Rating Bureau.

A second area of concentration for the research section was the operation of the health insurance market. An informational survey, begun in 1976, eventually served as a base for several projects in the health insurance field. The section was instrumental in drafting a 1977 administrative regulation for the operation of health maintenance organizations in the Commonwealth. In 1978, the section provided research and recommendations concerning the licensing of a controversial form of HMO known as the "independent practice association." Data collected on available insurance policy types also contributed to the 1978 publication of a consumer booklet entitled Insuring Your Health: A Guide to Buying and Using Health Insurance Policies.

As 1977 Zone I chairman for the National Association of Insurance Commissioners, Commissioner Stone was responsible for planning the annual zone meeting that year. The research and education staff organized a regional meeting that, for the first time in recent history, did not depend on insurance industry funding or event coordination. Commissioners and their staff members from the Zone I states prepared papers for presentation during the two-day session. The NAIC Zone I meeting presented an unusual opportunity for the regulators to consider their mutual problems with extensive written support materials and to benefit from the work of neighboring insurance departments.

Beginning in early 1977, the research staff worked closely with the Commissioner in developing legislation--enacted that December--which provided domestic life insurers a tax reduction in exchange for their establishment and funding of the Massachusetts Capital Resource Company, a one hundred million dollar investment fund specializing in investments which would create new jobs in Massachusetts. The General Court enacted legislation in the same session authorizing the formation of prepaid legal service plans in Massachusetts. The research staff worked throughout 1978 to draft the operational regulations for the licensing and conduct of such plans.

In addition to its research activities, the section produced the Division's statutorily mandated Annual Reports for 1975, 1976 and 1977

and a comprehensive, multi-volume collection of Regulations and Decisions for the same three years.

Hearing Officers Section

Prior to 1975, there was no separation between Division executives responsible for preparing disciplinary and rate cases for hearing and those who sat as hearing officers. Often the same individual would play both roles. The Division reorganization in 1976 and 1977 included the transfer of three senior Division employees, Joseph F. Ciccio, Milton G. McDonald, and Mary F. Kingston, to full-time positions as Hearing Officers with the title of Deputy Commissioner. Taken together, the three hearing officers brought more than 80 years of Division employment experience to this task. The three full-time Hearing Officers are never involved in the preparation of cases. The Hearing Officers Section serves under the jurisdiction of the First Deputy Commissioner. The Hearing Officers, since 1976, have handled the vast majority of all disciplinary cases and contested policy form and company rate filings thus freeing the Commissioner and the First Deputy Commissioner of this responsibility.

Prior to 1977, records of hearing matters had been mixed with other material throughout the Division's files and had occasionally been lost. A docket system was established in the Hearing Officers Section to consolidate hearing records, to insure file integrity and security, and to provide quick reference.

II. Licensing and Examination Bureau

Financial Surveillance Section

In January of 1975, a section of six people was responsible for reviewing applications for insurance company licenses. That section reported to the First Deputy Commissioner. The Second Deputy Commissioner was responsible for in-office review of the financial statements filed by the companies. Most solvency protection work, however, was done in the field. Employees reporting to the Deputy Commissioner and Actuary conducted financial audits of retirement systems. Over a hundred insurance examiners conducted field audits of company financial condition. The new administration believed that the financial surveillance performance of the Division could be improved substantially by upgrading the in-office review of company statements and relying on independent CPA firms hired by insurance companies for much of the field examination work. By September of 1978, the Financial Surveillance Section included over 20 professionals working within the Division's offices. During the same period, the field examination staff had been reduced from 197 to 79.

Under the direction of Peter M. Mulcahy, the Financial Surveillance Section hired trained personnel and established sophisticated home office auditing procedures. In May of 1976, ten positions carrying the newly created title of Insurance Auditor were added to the Division's

authorized list. Eight of these were assigned to the Financial Surveillance Section. The positions were structured in two grades--Insurance Auditor I and Insurance Auditor II. The salaries ranged from $16,000 to $20,000 for Insurance Auditor I and from $19,500 to $24,000 for Insurance Auditor II, as opposed to a range from $12,000 to $17,000 for traditional non-management examiner positions. These reasonably competitive salaries permitted the Division to attract educated and experienced auditors.

In March of 1976, the Division issued Regulation 1-76 to require insurance companies to submit annual audited statements prepared by independent certified public accountants. The new CPA opinions and the traditional annual statements were both used by the Financial Surveillance Section, with other existing financial reports, to conduct a complete and reliable evaluation of company condition.

Following promulgation of the regulation and the organization of the Financial Surveillance Section, working procedures were established to grade companies by the level of financial review required so that personnel resources could be effectively allocated where most needed. In November of 1976, four levels of priority were established. Priority I included all companies posing a serious risk of insolvency, those subject to license suspension or revocation within the previous year, and those requiring particular scrutiny of business practices. Priority I companies are required to submit monthly data and other special reports as necessary to maintain constant surveillance of their activities. Approximately three percent of all companies are currently assigned to the Priority I category.

Priority II companies are those whose financial positions suggest possible future problems, companies with licenses suspended or revoked within the last five years but not within the last year, companies licensed for less than two years, and companies identified for special attention to business practices. Priority II companies are required to file quarterly financial reports and other information as needed. Approximately 21% of all companies are in this category. Priority III companies include those showing no serious problems at present but whose size or track record makes a change in status possible. Also included are companies with financial problems but very limited involvement in Massachusetts markets. Priority III companies comprise 38% of all licensees.

Priority IV is the designation for companies believed to be in a financially healthy and stable condition. The principal auditing goal for this category is the verification of continued stability. Priority IV status is given to approximately 38% of all companies.

The new financial surveillance procedures have proved successful in reducing the time allocated to routine audit tasks. Analysis time is now concentrated on companies within the Priority I and Priority II

classifications. The emphasis on problem companies allowed the Division to identify serious risks in the financial condition of the Loyal Protective Life Insurance Company in 1977. The Division promptly sought court appointment as temporary receiver. The company was successfully reorganized to avoid an insolvency.

Field Audit Section

Changes in the Financial Surveillance Section permitted substantial reductions in the number of field examiners. With the reorganization of 1976, six separate field examination sections were consolidated into a single Field Audit Section. In February of 1977, the retirement systems examination staff and the Agents and Brokers examination staff were transferred to the Field Audit Section. The section's new Director, Paul L. Sweeney, joined the Division in October of 1976 from a position as an audit supervisor for the national public accounting firm of Coopers & Lybrand. Mr. Sweeney was the first C.P.A. to serve as Chief Examiner in the Division.

Mr. Sweeney's first assignment was to develop a training program for existing personnel. Instructors from independent public accounting firms and from the Division's senior staff were recruited to give courses in basic audit procedures to all employees. Participation in training was mandatory. At the completion of a series of instruction sessions, examiners were given written tests to evaluate their progress.

Under the previous organizational structure, field examiners had been given narrowly described tasks, divided by major line of insurance. They acquired experience only in one task within one line. Upon reorganization, all examiners were assigned to a variety of tasks and company types. This change in procedure expanded each examiner's understanding of the audit function and opportunity for promotion. Much of the work of field examiners prior to reorganization had been devoted to recounting assets and liabilities previously reported by the companies in their statutory annual statements. The new procedures focused examiners' attention on those parts of the companies' books and records where financial or business conduct problems were most likely to appear. Rather than merely counting columns of numbers and verifying reported figures, the examiners were trained to review each company's internal control procedures and to provide a critical evaluation of the company's condition.

With the reduction in staff, it was necessary to establish new assignment procedures to keep track of the progress of each examination and to make best use of each examiner's time. Records were kept of the time required to complete each element of the examination to assist in future planning.

Paul Sweeney resigned from the Division in October of 1978 and was replaced as Director by Alan J. Wright.

Special Investigation Section

The Special Investigation Section was established in 1976 under the direction of Martin Kelley. It replaced a fraudulent claims investigation squad set up prior to the institution of bodily injury no-fault and continued in operation long after its statutory function had been virtually eliminated. Fifty claim investigators were terminated after a public hearing in the summer of 1975. The remaining six employees were assigned to the new section. The section investigates alleged violations of insurance laws for referral to the Legal Section for administrative enforcement actions and to criminal authorities for prosecution. Questionable practices uncovered during examinations by the Field Audit Section, during the handling of consumer complaints by the Consumer Service Section, and during review of license applications by the Agents and Brokers Section are investigated by the section's personnel. Investigatory jurisdiction extends to all licensees of the Division, as well as the traditional jurisdiction of the Fraudulent Claims Board.

Agents and Brokers Licensing Section

The duties of the Agents and Brokers Licensing Section include evalation of license applications, issuance of licenses and renewals, and maintenance of current records of licensees. From January of 1975 to October of 1977, Vincent P. O'Brien served as Director of the section. Mr. O'Brien retired in 1977 and was succeeded by Charles H. Sullivan.

Prior to October of 1976, the Section was responsible for constructing and administering all examinations required of applicants. To improve the quality of the examinations, better facilitate their administration and supplement state expertise, the Division entered into an agreement with the Educational Testing Service of Princeton, New Jersey. The contract authorized ETS to prepare an agents examination under the supervision of the Commissioner, to administer it and to report results. The new testing routine has been found extremely successful by companies, agents and Division managers.

III. Legal and Consumer Service Bureau

Legal Section

The principal goal of the Legal Section during the reorganization was the hiring of additional attorneys. Between August of 1976 and September of 1977, eight new attorneys joined the staff. To monitor the performance of the enlarged staff, a case management system was initiated by which all assignments were made in writing and all work products were reviewed by the section supervisor. In making case assignments, the Director of Legal Services attempted to introduce all staff lawyers to each aspect of insurance regulation. Gradually, individual attorneys were encouraged to develop specialization in particular subjects.

The Legal Section had primary responsibility for the drafting of Division regulations. Among the subjects of regulations between 1975 and 1978 were Division hearing procedures, the Plan of Operation for the automobile reinsurance facility, a statewide standard merit rating plan, and rules for the licensing and conduct of damage appraisers.

The Legal Section initiated numerous enforcement actions leading to suspension or revocation of licenses and the imposition of monetary penalties. The Division's staff attorneys, the Special Investigation Section and the Field Audit Section, working with law enforcement agencies, have uncovered numerous cases of serious consumer fraud. As a

result of these actions, over a million dollars has been recovered by injured policyholders. Among the most egregious cases have been those involving misrepresentations in sales of health insurance to the elderly and systematic overpricing of auto insurance premiums in inner city areas. The unprecedentedly vigorous enforcement program was designed for both punitive and deterence effect.

In addition to the drafting of documents and enforcement activity, a substantial portion of the Legal Section's time was devoted to servicing the legal needs of other sections within the Division. Services typically included assisting the consumer complaint staff and advising the Financial Surveillance, Field Audit, Policy Approval and Agents and Brokers staffs. Numerous inquiries from insurance companies and agents, the public, and other government agencies were answered. Legal opinions, contrary to Division tradition, were offered only in writing in response to a written request and only after clearance by the Commissioner or First Deputy Commissioner.

From 1976 to July of 1978, Michael Unger served as Director of the Legal Section. He was subsequently appointed Acting Chief Counsel for the Division and succeeded as Director of Legal Services by Joan A. Gerrity.

Consumer Service Section

Prior to 1975, consumer complaints and inquiries received by the Division were widely dispersed throughout the office. There was little consistency in assignment, treatment or result. Consumers routinely received advice from unauthorized and occasionally untrained personnel. This procedure not only served the public badly but it also placed substantial burdens on Division technical employees whose normal work was constantly interrupted by consumer inquiries presumed to be within their area of expertise.

In late 1975 and early 1976, all consumer complaint functions were consolidated into a single Consumer Service Section under the direction of Joseph A. DiGiovanni, Jr. Ten complaint handlers were reassigned to the new section, which was designated as the exclusive first point of contact between the Division and members of the public. Caseworkers were instructed to investigate each complaint, evaluate its merits and either recommend to the licensee that an adjustment be made in favor of the policyholder or explain to the policyholder why the complaint was not justified. In complex cases, investigators participate in face to face meetings between complainants and industry representatives in the Division's offices.

Consumer Service Section personnel experienced some difficulty at first in adjusting to the new procedures. In the past, they had seldom been required to make judgments on the merits of complaints. Changes in staff and intensive training served to remedy this problem. As consumers

learned that meaningful aid was often available, the complaint volume increased steadily. The telephone system for the Consumer Service Section had to be restructured and consolidated with the main number for the Division in the public reception area.

In late 1976, the Consumer Service Section worked with the research staff to develop a computerized information system to record the productivity of the caseworkers, the number and type of complaints received, the frequency of complaints against particular licensees, and the results of actions taken. Under the new system, each caseworker completed a coding sheet for each complaint handled, giving a profile of the complaint and its disposition. The Director of Consumer Services would then forward processed information to the Field Audit, Financial Surveillance, Special Investigation and Legal Sections for follow-up where patterns of abuse appeared.

During 1975 the Division handled 5,995 complaints. In 1976, a total of 10,658 cases were closed. In 1977 and 1978, the volume was still greater.

Board of Appeal

For many years, the Board of Appeal on Motor Vehicle Liability Policies and Bonds had been statutorily authorized to handle contested cases involving suspension or revocation of drivers licenses and cancellations of auto insurance policies. The latter function was rendered obsolete by strict prohibitions on cancellations enacted early in this decade. The number of appeals concerning drivers license decisions in 1975 was approximately 1,400. The staff of the Board included a Secretary, a Head Clerk, a Senior Clerk and an Insurance Department Inspector. The total cost of operation for the Board in 1975 was less than $50,000.

The automobile insurance reform law of 1976 gave the Board significant additional responsibilities in the hearing of appeals from merit rating surcharges. In November of 1976, a separate budget account was established for the Board outside the administrative budget of the Division of Insurance. The Board began processing merit rating appeals in mid-February of 1977. The merit rating surcharge appeals soon became the dominant activity of the Board. By year end 1977, over 18,000 appeals had been filed. Appeals are filed on approximately 10% of all surcharges.

When separated from the Division, the Board was initially assigned nine personnel positions. Four additional employees were transferred from the Division to the Board of Appeal in January of 1977. As of November of 1978, the Board has a total of fifteen permanent and six temporary employees. It operates under the direction of its Chairman, appointed by the Commissioner of Insurance, and two members, one appointed by the Attorney General of the Commonwealth and the other appointed by the Registrar of Motor Vehicles.

Throughout the period, Ralph A. Iannaco has served as Secretary to the Board. Roderick L. Ireland served as Chairman from July to November of 1977. Benjamin Jones has served as Chairman since Mr. Ireland resigned to become a Judge in the Boston Juvenile Court.

IV. State Rating Bureau

For at least thirty years, most states have had laws mandating extensive insurance price regulation, particularly in the property-casualty lines. State insurance regulatory agencies in the various states have typically been required to review many thousands of company rate filings annually. Few, if any, of the states have had the trained personnel needed for meaningful review. Prior to 1974, the Massachusetts Division of Insurance had only one employee with membership in the Casualty Actuarial Society. Most states have had no actuaries with such certification.

In August of 1975, the rating bureau operated by the Massachusetts insurance industry filed for a proposed rate increase of 40% over existing 1975 rates. The recommendations appeared to be consistent with traditional automobile insurance rate-making techniques. The Massachusetts public, the press and the legislature were shocked. Commissioner Stone, still in his first few months of office, promised an unprecedentedly thorough evaluation of the industry's proposal and the traditional rate-making methods used to support it.

The decision on 1976 bodily injury automobile insurance rates was issued in November. It introduced a new technique for the explicit recognition of investment income in rate-making. The new technique implied a substantially lower profit margin in the established premium levels than had previously been assumed necessary. The decision also altered the traditional method of computing company expense allowances. In place of a single percentage allowance which varied expenses automati-

cally in proportion to claims costs, the Commissioner adopted an entirely independent trending technique based solely on factors influencing the expenses themselves. This new approach permitted consideration of normative evidence, involving insurer efficiency, as well as predictive evidence in setting appropriate expense allowances. Finally, the bodily injury rate decision forewarned insurers that long accepted methods of classifying risks would be subject to challenge in the future. The emphasis on rating by age, sex and marital status was cited as particularly disturbing in light of its broad statistical grouping of unlike individuals and its lack of useful behavioral incentives.

The bodily injury decision and the decision on property damage coverages which followed in December, further refining the new investment income and expense methodologies, granted insurers a rate increase only about one third of the original request. Industry reaction was sharply critical, and court challenges were promptly filed. Many insurers threatened to cease doing business in the Commonwealth unless the decision was rescinded. The threats were soon withdrawn in favor of a reliance on the court appeals. Nearly a year later, the Supreme Judicial Court of Massachusetts upheld the entire decision and dismissed the appeals. As it eventually turned out, the 1976 rates determined by the contested decisions were fully adequate for a fair return on investment by insurers.

The intense controversy surrounding 1976 automobile insurance rates forced a rapid education of the Massachusetts public on the subject. Numerous legislators voiced awareness of the enormous difficulties faced by the limited actuarial staff of the Division in responding to rate filings. Late in 1975, the Legislature enacted Chapter 728 establishing a State Rating Bureau in the Division of Insurance and providing for the first time a strong complement of trained actuarial talent.

Ten new statutory positions with competitive salaries were created, including six actuary/statisticians, two certified public accountants and two attorneys. The actuary/statisticians were required to be either members of the Casualty Actuarial Society or the Society of Actuaries or holders of doctoral degrees in related disciplines. An additional eight support positions, including four actuarial assistants, two counsels and two administrative secretaries, were also added. Personnel employed by the Division prior to 1976 completed the support staff. In July of 1976, James H. Hunt was named Director of the State Rating Bureau and Stewart W. Kemp was named Associate Director and Chief Counsel. The State Rating Bureau presently maintains a staff of about 24 employees. The total cost was about $290,000 in 1978, less than 5¢ per $100 of automobile insurance premiums.

Throughout 1976, the Massachusetts Legislature continued its inquiry into automobile insurance problems. Major structural legislation was enacted in August, establishing a uniform state-supervised merit rating system to vary individual premiums with at-fault accident and traffic violation frequency. The new law at the same time altered the accustomed Massachusetts scheme of price regulation. Insurance companies

were permitted to set their own rates as long as competition was found to be adequate. The Division was actively involved in the preparation of this legislation, although it was unsuccessful in persuading the Legislature to phase in the rating deregulation provision over a gradual transition period.

As soon as passage of the 1976 reform law became imminent, the State Rating Bureau began preparatory work for the flood of company filings it was to receive in place of the traditional Massachusetts all-industry filing. Detailed filing forms were promulgated so that the competitive filings of 1977 rates under the new law could be reviewed consistently. The forms, with slight amendments, have served as the basis for subsequent filings each succeeding year.

Early in 1977, serious problems with the experiment in insurer pricing freedom became evident. Many companies had set 1977 rates for certain classes of policyholders dramatically above 1976 levels. Drivers classed as young, male or urban received the greatest increases. Consumers charged that price information was being systematically withheld. Unanticipated company assignment of large numbers of clean drivers to a special high risk rate in the reinsurance facility swelled company incomes beyond what their filings had contemplated. The Division undertook extensive investigations of the situation in order to plan appropriate administrative actions and recommend a corrective course to the Legislature. The State Rating Bureau became almost totally occupied with its tasks in connection with these investigations.

In July, the Legislature passed an Administration supported bill ordering policyholder rebates. Revisions to the reinsurance facility's authorizing statute limited the imposition of a high risk rate to drivers with objectively poor operating records and granted the Commissioner the right to promulgate the facility's Plan of Operation.

Invoking a protective clause in the 1976 reform statute, the Commissioner found that company competition, as operating in 1977, was not sufficient to protect policyholders against excessive or unfairly discriminatory rates. He ordered a temporary return to state-made premium rates for 1978 and issued a hearing notice which clearly cited the possibility of major changes in the state's approach to classifying drivers for insurance rating purposes.

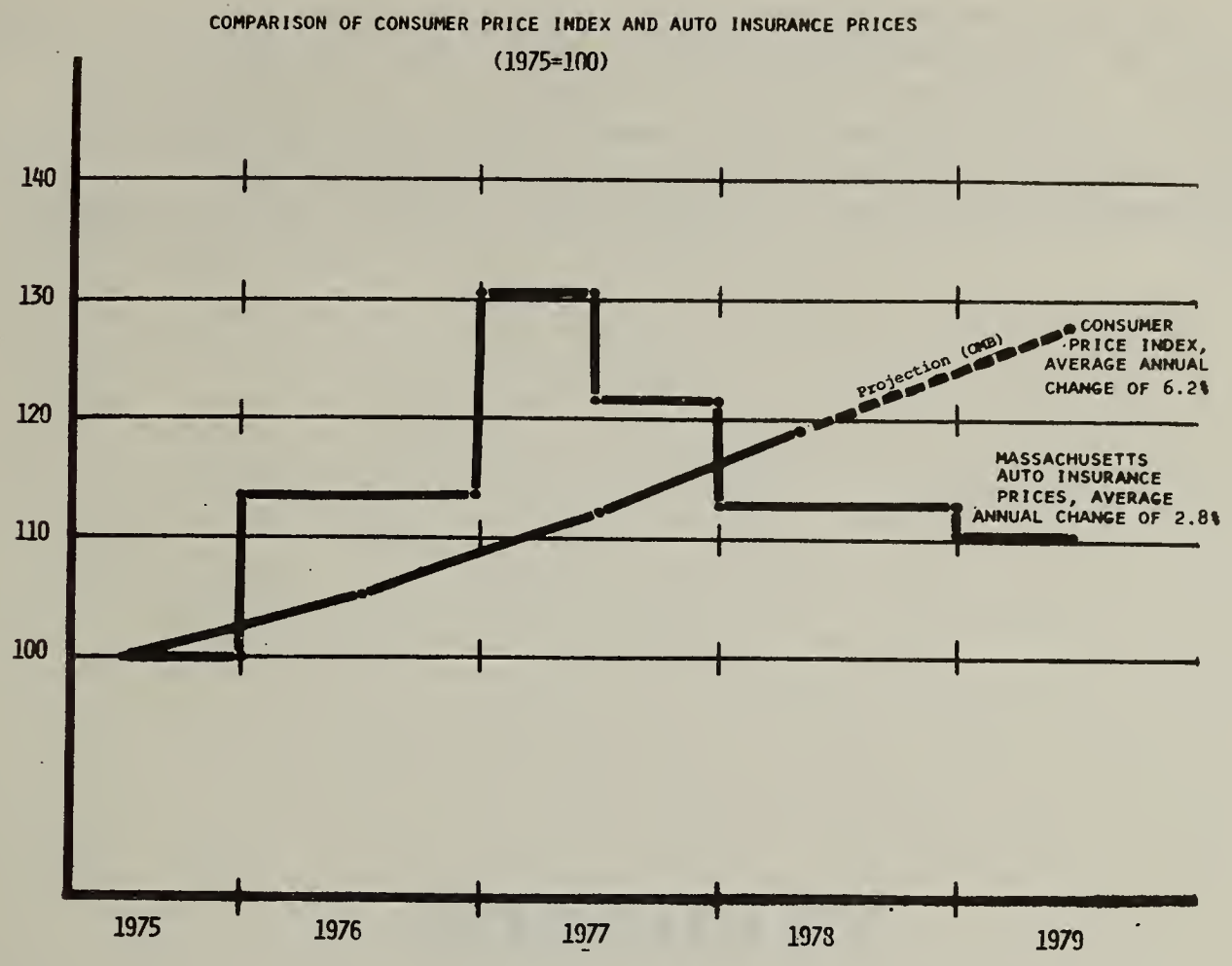
The State Rating Bureau, with the help of other sections of the Division, worked throughout the summer to produce a complete analysis of risk assessment and relative pricing approaches in automobile insurance. By the time the rate-making hearing commenced in October, the staff had completed a 700 page filing which detailed its recommendations for 1978 rates. The State Rating Bureau's Chief Counsel then presented its case at the month-long hearing, during which some forty expert witnesses offered their views.

The decision establishing 1978 rates was issued by the Commissioner

in December. It accepted most of the suggestions for changes in classification techniques suggested by the State Rating Bureau. Drivers were no longer to be rated on the basis of youth, sex or marital status. Instead, primary relative pricing emphasis was shifted to variables within the control of the policyholder and providing a useful incentive effect on claims frequency. Territorial rating was not precipitously eliminated, but geographically determined differentials were greatly attenuated by the substitution of flat per-exposure company expense and facility deficit loadings for the customary percentage allowances. Merit rating, using individual driving histories, became the most important discriminant in establishing premium differentials. Discounts were given to drivers installing effective anti-theft equipment in their vehicles and to inexperienced drivers having completed an accredited driver education course. The overall statewide rate total was reduced by approximately 12% to reflect the already successful incentive impacts of the 1976 merit rating law.

The public responded well to the new pricing philosophy. Insurers expressed some skepticism but did not appeal the Commissioner's decision to the courts. During 1978, the concept of individual incentive pricing received widespread attention in other jurisdictions. Division representatives were invited to present testimony on the subject in New York, New Jersey, Florida, Pennsylvania, Illinois, Texas and other states. The 1979 rate filings of both the industry and the State Rating Bureau recommended retention of the restructured classification plan. The State Rating Bureau urged in its advisory filing of September, 1978, that additional steps be taken as well. It suggested a partial flattening of agents commissions across classes and territories, to be implemented by confining commission calculations to a pre-established minimum and maximum range. It also urged increased tempering of the remaining geographical differentials in the rates to compensate for the effects of commuting traffic on core city areas and overlap between merit rating and other classification techniques.

All of these suggestions were embodied in the Commissioner's decision on 1979 rates. He also accepted a recommendation of the Massachusetts Bay Transportation Authority to create a discount for regular pre-paid users of public transit systems. The emphasis on individual incentive variables in automobile insurance pricing gave the public of Massachusetts a four-year insurance cost record considerably better than that of the consumer price index over the same period. The contrast is shown in the table on the following page.



In line with its responsibility for review of policy forms, the State Rating Bureau worked with other sections of the Division to make automobile insurance more understandable as well as less costly. In 1976, an entirely new policy form for automobile insurance was drafted, eliminating all difficult verbiage and fine print from the contract. The readable policy form, along with annual buyers guides prepared by the Commissioner, contributed to a greatly improved public climate in the automobile insurance market.

In other regulated property-casualty lines, the State Rating Bureau employed the same analytical techniques it helped develop for automobile insurance. The use of a formal rate of return standard, precisely reflecting available investment income, was extended to medical malpractice, homeowners, workers' compensation and other major filings. The requirement that expenses, and expense trends, be established without an automatic ratio to claims costs was similarly extended. Partly as a result of these innovations, rate increases in most lines since 1976 have been well below the level of general inflation.

In late 1977, the Legislature--cognizant of the success of the readable policy form in automobile insurance--mandated that all policies sold in Massachusetts be written in plain, clear language. Companies were given until the middle of 1979 to make the necessary changes in their

forms. The State Rating Bureau, with the Research and Education Section, spent much of 1978 preparing standards for clarity and disclosure under the new law. Particular emphasis was given to health insurance and life insurance. Proposed standards for health insurers would greatly simplify coverage terms, while those for life insurers would introduce a rate of return disclosure requirement in connection with the sale of cash-value policies.

APPENDICES

Appendix A - Administrative Bulletins and Reporting Forms

1. Policy Concerning Outside Interests and Employment (#76-7) - August 25, 1976; Interpretation of Administrative Bulletin (#76-7) - September 17, 1976; Policy Concerning Outside Interests and Employment (#76-8) - September 17, 1976.
2. Attendance Record-Keeping Policy (#76-10) - October 13, 1976.
3. Office Decoration Policy (#76-13) - October 14, 1976.
4. Xerox Policy (#76-12) - October 27, 1976.
5. Skeleton Force Policy (#76-16) - November 17, 1978.
6. Printing Policy (#76-18) - November 30, 1976.
7. Delivery and Pickup Policy (#76-14) - December 1, 1976.
8. Travel Policy (#76-17) - December 9, 1976.
9. Solicitations (#77-1) - February 7,1977.
10. Sick Leave (#77-3) - February 23, 1977.
11. Check Distribution (#77-5) - March 21, 1977.
12. Grievance and Appeal Procedures (#77-4) - March 31, 1977.
13. Supplies - April 20, 1977.
14. Stockroom - June 21, 1977.
15. Performance Evaluation Policy (#77-7) - July 21, 1977.
16. Vacation Policy (#77-2) - August 17, 1977.
17. Tuition Reimbursement Policy (#76-9) - November 7, 1977.
18. Budget Reporting Forms (Sample Items).

Appendix B - Documents Concerning Financial Surveillance, Field Audit and Licensing

1. Rule 1-76, Rules and Regulations Regarding Audits of Insurers by Independent Certified Public Accountants.
2. Financial Surveillance Administrative Procedure #1 - Definition of Priority Designations.
3. Personnel Supervision Forms.
4. Agency Audit Guide.
5. Report of Association Examination of the Massachusetts Bay Insurance Company, Worcester, Massachusetts, as of December 31, 1976, (sample of financial examination report).
6. Report of Market Conduct Examination of the Life of America Insurance Corporation of Boston, Boston, Massachusetts, as of June 7, 1978, (sample of market conduct examination report).
7. Report of Examination of the City of Worcester Contributory Retirement System as of December 31, 1976 (sample of retirement system examination report).
8. Advisory Opinion - Educational Training Service.
9. Massachusetts Individual Insurance Broker Application.
10. Massachusetts Individual Insurance Agents and Brokers License Information.
11. Findings and Order of Keith R. Rodney re: Commissioner v. Maryland Casualty Company, August 24, 1976.

Appendix C - Reports of the Consumer Service Section and the Board of Appeal

1. Consumer Service Section Report, January 1, 1976 - December 31, 1976.
2. Consumer Service Section Report, January 1, 1977 - December 31, 1977.
3. Consumer Service Section Report, January 1, 1978 - June 30, 1978.
4. Board of Appeal Report - 1975.
5. Board of Appeal Report - 1976.
6. Board of Appeal Report - 1977.

Appendix D - Rules for the Conduct of Hearings and Other Adjudications

1. Regulation 2-76, Procedures For the Adoption of Regulations, July 8, 1976.
2. Regulation 3-76, Procedures For Request of Advisory Opinions, July 8, 1976.
3. Regulation 4-76, Procedures for the Conduct of Hearings of Motor Vehicle Insurance Rates, June 16, 1976.
4. Regulation 5-76, Procedures Concerning Rate Filings and the Conduct of Hearings for Motor Vehicle Insurance Pursuant to Section 7 of Chapter 175E of the Massachusetts General Laws, November 16, 1976.
5. Emergency Regulation 8-76, Procedures for the Conduct of Hearings for Medical Malpractice Insurance Rates Pursuant to Section 5A of Chapter 175A of the Massachusetts General Laws, October 18, 1976.
6. Emergency Regulation 5-77, Procedures Relating to Advisory Filings and the Conduct of Hearings Concerning Motor Vehicle Insurance Rating and Underwriting Practices and the Fixing and Establishing of Motor Vehicle Insurance Rates, May 17, 1977.
7. Regulation 5-78, Procedural Rules for Disciplinary Hearings, November 20, 1978.

Appendix E - Documents Concerning the Regulation of Life and Health Insurance

1. Regulation 4-77, Regulation of Health Maintenance Organizations Pursuant to Chapter 176G of the Massachusetts General Laws, June, 1977.
2. Opinion, Findings and Decision on the Application of Bay State Health Care Foundation, Inc., to be Licensed under General Laws, Chapter 176G, August, 1978.
3. Opinion, Findings and Decision on Blue Cross Non-Group Rates and on Rates and Riders for Mental Illness and Alcoholism Treatment, May, 1975.
4. Findings and Order re: Filing by Blue Shield of Massachusetts, Inc. for an Increase in Rates for Plan J Subscribers and for an Increase in Lifetime Maximum, Non-Group Major Medical Benefits, October 22,1975.
5. Opinion, Finding and Decision on a Filing by Blue Cross of Massachusetts Inc. of Riders for Non-Participating Hospitals, December 11, 1975.

6. Opinion, Findings and Decision on a Filing by Blue Cross of Massachusetts, Inc. for an Increase in Rates for Non-Group Subscribers Who Elect to be Insured under the Harvard Community Health Plan, January, 1976.
7. Opinion, Findings and Decision Concerning Proposed Rate Adjustments Filed By Blue Cross of Massachusetts, Inc. and Blue Shield of Massachusetts, Inc. for Non-Group Rates, March, 1977.
8. Order on Appeal by Blue Cross and Blue Shield from an Opinion, Findings and Decision Issued March 8, 1977 Disapproving Rate Adjustments for Non-Group Rates, April 29, 1977.
9. Opinion, Findings and Decision Concerning Proposed Rate Adjustments Filed by Blue Shield of Massachusetts, Inc. for Non-Group Plan J Rates, September, 1978.
10. Opinion, Findings and Decision on a Filing by Blue Cross of Massachusetts, Inc. for Increases in Rates for Medicare Extension Contracts (Medex), April, 1976.
11. Opinion, Findings and Decision Concerning Revisions in Medex Rates Effective January 1, 1977 Filed by Blue Cross of Massachusetts, Inc. and Blue Shield of Massachusetts, Inc., March, 1977.
12. Opinion, Findings and Decision Concerning Revisions in Medex Rates Filed by Blue Cross/Blue Shield, Issued February, 1978.
13. Opinion, Findings and Decision on Proposed Accident & Health Rates Requested by Four Insurance Companies of the Commercial Union Group, June, 1978.
14. Order on Appeal - Request for Approval of Premium Rate Increase for Certain Major Medical Expense Policies of Commercial Union Group, August, 1978.
15. Letter to American Council of Life Insurance Concerning Cost Disclosure, August 4, 1978.

Appendix F - Documents Concerning the Regulation of Casualty Insurance (Other than Automobile)

1. Opinion, Findings and Decision on 1975 Workmen's Compensation Rates, May, 1975.
2. Disapproval Letter - General Revisions of Rates Filed August 13, 1976, October 28, 1976.
3. Opinion, Findings and Decision Concerning Rate Revisions to Recognize Law Benefit Increases Proposed by the Worker's Compensation Rating and Inspection Bureau of Massachusetts, July, 1977.
4. Opinion, Decision and Order concerning Workers' Compensation Service Fees Provided in Regulation 5-74, October 4, 1977.
5. Amendment #1 to Regulation 5-74 - Workers' Compensation Service Fees, October 4, 1977.
6. Brief of the State Rating Bureau Relating to the General Revision of Rates Filed by the Workers' Compensation Rating and Inspection Bureau of Massachusetts, December 20, 1977.
7. Opinion, Findings and Decision on Workers' Compensation Rates, January, 1978.
8. Approval Letter for General Revision of Rates to be Effective April 1, 1978, April 3, 1978.

9. Opinion, Findings and Decision on Classification of Risk and Premium Charges for Medical Malpractice Insurance and Addendum to That Decision, December, 1975.
10. Advisory Filing of the State Rating Bureau in Connection with a Hearing and Investigation to Fix and Establish Classifications of Risks and Premium Charges for Medical Malpractice Insurance Policies, December 1, 1976.
11. Brief of the State Rating Bureau in Connection with Medical Malpractice Insurance for 1976 and 1977, January, 1977.
12. Opinion, Findings and Decision on 1976 and 1977 Medical Malpractice Insurance Rates, March, 1977.
13. Opinion, Findings and Decision on 1978 Medical Malpractice Insurance Rates Issued March, 1978.
14. Opinion, Findings and Decision on 1979 Medical Malpractice Insurance Rates, November, 1978.
15. Advisory Opinion - On Termination of Multiple Year Standard Form Fire Insurance Policies, March 7, 1977.
16. Opinion, Findings and Decision on Fair Plan Rates, March 9, 1977.
17. Findings and Conclusion on Proposed Homeowners Rates Requested By Prudential Property and Casualty Insurance Company, July, 1978.

Appendix G - Documents Concerning the Regulation of Automobile Insurance Rate Hearing Matters

1. Opinion, Findings and Decision on 1976 Automobile Bodily Injury Coverage Rates, Rendered November, 1975.
2. Opinion, Findings and Decision on 1976 Automobile Property Damage Coverage Rates, Rendered December, 1975.
3. Correction Notice of the Opinions, Findings and Decision on 1976 Automobile Property Damage Coverage Rates Rendered December, 1975, Rendered January 5, 1976.
4. Regulation 6-76 - Prescription of Forms for Rate Filings Pursuant to Section 7 of Chapter 175E of the Massachusetts General Laws, October 6, 1976.
5. Opinion, Findings and Decision on Proposed Territories for 1977, Rendered October, 1976.
6. Opinion and Findings on the Operation of Competition Among Motor Vehicle Insurers, Rendered June, 1977.
7. Instructions for Implementation of Chapter 365 of the Acts of 1977, Promulgated July 7, 1977.
8. Supplementary Opinion and Decision on the Operation of Competition Among Motor Vehicle Insurers, Rendered August, 1977.
9. Regulation 6-77 - Rules and Regulations Regarding Reductions in Premium Charges for Private Passenger Motor Vehicles and Certain Commercial Motor Vehicles Equipped with an Anti-Theft Mechanism as Authorized by Section 4(d) of Chapter 175E of the Massachusetts General Laws, May 6, 1977.
10. Hearing Notice for 1978 Auto Rate Hearing, August 5, 1977.
11. Advisory Filing of 1978 Private Passenger Auto Insurance Rates of the State Rating Bureau, September 26, 1977.

12. Brief of the State Rating Bureau Relating to the Fixing and Establishing of Premium Charges to be Used in Connection with Motor Vehicle Insurance Policies in 1978, November 15, 1978.
13. Opinion, Findings and Decision on 1978 Automobile Insurance Rates, December 28, 1978.
14. Opinion, Findings and Decision on the Operation of Competition Among Motor Vehicle Insurers, Rendered June, 1978.
15. Regulation 4-78 - Covering Anti-theft Device Discounts, July 27, 1977.
16. Notice of 1979 Auto Rate Hearing.
17. Advisory Filing of 1979 Private Passenger Automobile Insurance Rates of the State Rating Bureau, August 28, 1978.
18. Brief of the State Rating Bureau Relating to the Fixing and Establishing of Premium Charges to be Used in Connection with Motor Vehicle Insurance Policies in 1979, October 11, 1978.
19. Opinion, Findings and Decision on 1979 Automobile Insurance Rates, November, 1978.

Merit Rating

20. Regulation 3-77 - Standard Merit Rating Plan, February 3, 1977.
21. Information About Merit Rating, Information Booklet Issued with Merit Rating Board, Summer, 1977.
22. Regulation 3-78 - Standard Merit Rating Plan, August 15, 1978.
23. Merit Rating Implementation Plan, Issued on April 26, 1978.
24. Merit Rating Credit Plan, August 21, 1978.

Massachusetts Motor Vehicle Reinsurance Facility

25. Report of Examination: Assignments to the Motor Vehicle Insurance Facility, May, 1977.
26. Findings, Decision and Order Concerning the Operation of the Massachusetts Motor Vehicle Reinsurance Facility, Rendered July, 1977.
27. Findings, Decision and Order Concerning the Proposed Plan of Operation Filed by the Governing Committee of the Massachusetts Motor Vehicle Reinsurance Facility, Rendered September, 1977.
28. Plan of Operation of the Massachusetts Motor Vehicle Reinsurance Facility, Promulgated October 27, 1977.
29. Emergency Rule of Operation 1, December 15, 1977.
30. Emergency Rule of Operation 2, December 30, 1977.
31. Decision on Appeal Concerning the Rules of Operation of the Massachusetts Motor Vehicle Reinsurance Facility, February 14, 1978; Decision on the Rules of Operation, December 30, 1977.
32. Decision on Appeal of Allstate Insurance Company from Rulings of the Massachusetts Motor Vehicle Reinsurance Facility Governing Committee, February 14, 1978.
33. Decision on Appeal of the Commercial Union Insurance Companies from Rulings of the Massachusetts Motor Vehicle Reinsurance Facility Governing Committee, February 14, 1978.

34. Opinion, Decision and Order Concerning the Amendment to Rule 2 and Proposed Rules 18A and Rule 19A as Filed by the Massachusetts Motor Vehicle Reinsurance Facility, March 16, 1978.
35. Opinion, Decision and Order Concerning Amendments to Rules 2 and 6 and Proposed Rule 3A as Filed by the Massachusetts Motor Vehicle Reinsurance Facility, April 6, 1978.
36. Opinion, Decision and Order Concerning the Proposed Amendment to Rule 6 as Filed by the Massachusetts Motor Vehicle Reinsurance Facility, May 2, 1978.
37. Amendment to Rule 2 of the Plan of Operation, August 18, 1978.

Easy-to-Read Policy Form and Buyers Guides

38. Letter to Massachusetts Auto Rating Bureau and Guidelines for Policy Language Improvement, June 25, 1976.
39. Massachusetts Automobile Insurance Policy.
40. Buying Your Automobile Insurance, An Information Guide, December, 1975.
41. Notice to Companies Writing Motor Vehicle Insurance in Massachusetts, December 8, 1976.
42. Buying Your 1977 Automobile Insurance, A Consumer Guide, December, 1976.
43. Buying Your 1978 Automobile Insurance, A Consumer Guide, December, 1977.
44. Buying Your 1979 Automobile Insurance, A Consumer Guide, November, 1978.

Miscellaneous

45. Regulation 7-76 - Massachusetts Automobile Insurance Table of Short Rate Values, November 17, 1976.
46. Regulation 2-78 - Massachusetts Automobile Insurance Table of Short Rate Values, March 10, 1978.
47. Regulation 7-77 - Prescription of Forms of Motor Vehicle Theft Reports Pursuant to Section 113 O of Chapter 175 of the Massachusetts General Laws, June 14, 1977.
48. The Massachusetts Mandatory Offer Laws: A Report to the General Court Pursuant to Section 7 of Chapter 365 of the Acts of 1977.
49. Advisory Opinion and Ruling re: Interest Charges on Automobile Premium Bills, Donald C. Hillman, March 8, 1978.
50. Regulation 1-78 - Regulation Concerning the Appraisal and Repair of Damaged Motor Vehicles.